



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	<b>02/23/07</b>	Bill No:	<b>AB 1120</b>
Tax:	<b>Sales and Use</b>	Author:	<b>Tran</b>
Related Bills:			

## BILL SUMMARY

This bill would provide a state sales tax (6.25%) exemption for the sale of disaster preparedness products, as specified, during a nine-day period in October of each year until January 1, 2011.

## ANALYSIS

### CURRENT LAW

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded.

Under current law, sales of disaster preparedness products such as batteries, first aid kits, gas or diesel fuel containers, ground anchor systems, food storage coolers, portable generators, flashlights, radios, battery-operated emergency beacons, and tie-down kits, are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute.

Under the Revenue and Taxation Code, the rate of tax currently applicable to retail sales of such disaster preparedness products is made up of various components:

- 5 percent state tax allocated to the state's General Fund (Sections 6051, 6201, 6051.3, and 6201.3).
- 0.25 percent state tax allocated to the Fiscal Recovery Fund which is dedicated to the repayment of Economic Recovery Bonds (Sections 6051.5 and 6201.5).
- 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local government for program realignment (Sections 6051.2 and 6201.2)
- 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).
- 1 percent under the Bradley-Burns Uniform Local Sales and Use Tax Law which is allocated to cities and counties (Part 1.5, commencing with Section 7200). Of the 1 percent, 0.25 percent is for county transportation funds and 0.75 percent is for city and county general operations.

- Various tax rates, under the Transactions and Use Tax Law, are allocated to special taxing jurisdictions in various counties and cities within the state (Part 1.6, commencing with Section 7252).

#### PROPOSED LAW

This bill would add Section 6399 to the Sales and Use Tax Law to provide a partial sales tax exemption (6.25%) for the sale of “qualified disaster preparedness products,” beginning at 12:01 a.m. on the first Saturday in October, and ending at 12:00 midnight on the second Sunday in October (the bill would be operative from January 1, 2008 until January 1, 2011). This bill would provide that “qualified disaster preparedness products” include the following:

- Rechargeable and non-rechargeable batteries (AA, C, D and 6-volt), for a retail price not to exceed \$40. Automobile and boat batteries are excluded.
- First aid kits, for a retail price not to exceed \$40.
- Battery-operated emergency beacons, for a retail price not to exceed \$50.
- Gas or diesel fuel containers, for a retail price not to exceed \$35.
- Ground anchor systems to secure tarps, for a retail price not to exceed \$60.
- Non-electrical food storage coolers, for a retail price not to exceed \$40.
- Portable generators, for a retail price not to exceed \$850.
- Battery powered flashlights and lanterns, gas powered lanterns, and candles, for a retail price not to exceed \$30.
- Self-powered and battery powered radios, including two-way radios and weather-band radios, for a retail price not to exceed \$60.
- Tarpaulins, for a retail price not to exceed \$60.
- Tie-down kits, including bungee cords and rope, for a retail price not to exceed \$60.

The proposed partial exemption would apply to layaway agreements entered into during the specified period for which the purchaser has made a deposit of at least 10 percent of the sales price.

The proposed partial exemption would also apply to orders placed during the specified period and paid for in full regardless of the fact that delivery of the article is made subsequent to the specified period.

This bill specifies that the exemption *does not apply* to the Bradley-Burns Uniform Local Sales and Use Tax or the Transactions or Use Tax, unless the governing body of the county, city, or district votes to have the exemption apply. Any governing body that votes to have the exemption apply would be required to notify the Board no later than August 15 of each year.

The provisions of this bill would become operative on January 1, 2008, and would remain in effect until January 1, 2011, and as of that date are repealed, unless a later enacted statute deletes or extends that date.

## BACKGROUND

This proposed law is modeled after a similar law in Florida, which went into effect in June 2005. Sales of similar disaster preparedness products are exempt from tax during Florida's 12 day *Hurricane Preparedness Sales Tax Holiday* period starting on the first of June, to coincide with the start of the hurricane season. It was enacted to encourage residents to prepare for the hurricane season. This sales tax holiday is separate from Florida's other sales tax holiday for footwear, clothing, certain accessories, and books, which occurred during the last nine days of July in 1998, 1999, 2000, 2001, 2004, 2005, and 2006.

There are sixteen states that will have sales tax holidays in 2007 for the purchase of clothing, school supplies, and/or computers: Connecticut, District of Columbia, Florida, Georgia, Iowa, Louisiana, Maryland, Massachusetts, Missouri, New Mexico, New York, North Carolina, South Carolina, Tennessee, Texas, and Virginia.

New Jersey, Pennsylvania and Rhode Island offer a limited year-round sales tax exemption on clothing.

California has had several "sales tax holiday" bills introduced over the years that would have provided a sales tax exemption for certain types of merchandise. Two sales tax holiday bills were introduced during the 2005-06 Legislative Session. AB 2089 (Tran) was identical to this bill. AB 2089 was held under submission in the Assembly Revenue and Taxation Committee. AB 548 (Garcia) would have provided a sales tax exemption for the sale of any article of clothing, clothing accessories, footwear, and school supplies, during a one-week period in August 2006. AB 548 was also held under submission in the Assembly Revenue and Taxation Committee.

## COMMENTS:

- 1. Sponsor and Purpose.** This bill is sponsored by the author to create a partial exemption for the specified disaster preparedness products during a specific period of the year, until January 1, 2011, and help California residents prepare for natural disasters.
- 2. Local option provisions could be problematic.** This bill would enable local jurisdictions the option of *voting to join in* the sales tax holiday period with respect to their locally-imposed taxes. Unlike other states, California has three levels of locally-imposed taxes: county-imposed, city-imposed, and district-imposed. Under this bill, any governing body of California's 58 counties *could vote* to have their 0.25 percent county transportation tax *included in the exemption*, as could the 478 governing bodies of California's cities and the 87 governing bodies of the state's transactions and use tax districts. It is unknowable how many governing bodies would vote to *opt in* with the proposed tax holiday but it is conceivable that the holiday exemption could range from 6.25 percent to a complete exemption with varying rates in between, depending on the location of sale. Also, rates within a single county could vary. For example, in Sacramento, Arden Way runs both within the city limits and the unincorporated area of Sacramento County. If the city officials vote to participate in the holiday exemption, but the county officials take no action, a customer purchasing clothing from a retailer in the city portion of Arden Way could have a

different rate imposed on the same items from a retailer on the county side of Arden Way.

There are several problems associated with partial tax exemptions. First, customers that have to pay any portion of the sales tax during the holiday period would be confused – most of California’s consumers are unaware of the varying components in the sales tax rate. Second, retailers selling items both included and excluded within the proposed partial exemption would have to segregate sales between those subject to whatever local tax may apply on the exempt sales, and those sales that are fully taxable, which adds a new level of complexity with respect to bookkeeping. Third, retailers having retail locations in multiple jurisdictions would have a more complex record-keeping task with potentially numerous rates, which could result in a larger margin of error in collecting and reporting the correct amount of tax. And fourth, the Board’s administrative costs could be proportionately higher if some locally imposed taxes apply and some do not, adding a new area of complexity not currently associated with return processing. Additional programming costs would be incurred as well.

3. **Partial exemption applies to layaway sales and other orders placed during the specified period.** Due to the partial exemption only applying during a specific time period, the bill contains language to address certain transactions that may qualify for the partial exemption but are not completed during the specified period. The bill provides that layaway agreements entered into during the specified period, for which the purchaser has made a deposit of at least 10 percent of the sale price, would qualify for the partial exemption. The bill also provides that orders placed during the specified period and paid for in full, but delivered subsequent to the specified period, would also qualify for the tax exemption.
4. **The partial exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. As an example, if a customer purchases a 5 horsepower (HP) portable generator and exchanges the generator for a 10 HP generator, the transaction is regarded under the law as a separate sale of the 10 HP generator and a rescission of the original sale of the 5 HP generator. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the Board, the sales price of the 5 HP generator, and is also required to include in his or her taxable sales amount, the sales price of the 10 HP generator. Using this example under the proposed holiday period, if the 5 HP generator is purchased during the sales tax holiday period, and is exchanged for the 10 HP generator *after* the holiday period, the proposed partial exemption would not apply to the exchange of the 10 HP generator since that transaction is recognized under the law as having occurred after the specified period. This may result in reporting errors by retailers and added confusion and inquiries by customers.

Another source of confusion could result from the use of rain checks. Current law also provides that a rain check issued by a retailer does not constitute a sale of tangible personal property. Therefore, if a retailer is out of stock of a particular item

and issues a rain check to the customer during the specified period, and the customer subsequently uses the rain check to purchase the out of stock item after that nine-day period, then the partial exemption would not apply.

5. **The partial exemption could increase retailer's costs.** Creating a partial exemption that only lasts for nine days would place an additional burden on retailers to have their cash registers programmed to tax sales on certain dates and not tax sales on other dates, or apply a partial rate of tax on certain dates. This may require retailers to incur costly and frequent reprogramming of their registers to accommodate the change. Retailers would presumably be compensated for this by increased sales activity during the specified period.

Based on information in a 1990 report that the Board prepared to determine the impact on retailer's costs with respect to implementing a tax increase in 1989, on average, retailers with quarterly prepay accounts spent \$94.35 to reprogram their cash registers and computers. Retailers with monthly and quarterly accounts paid \$19.47. Adjusting these figures for an increase in the California Consumer Price Index and the increase in the number of accounts since the 1990 study, it is estimated that retailers incur approximately \$9.3 million in comparable reprogramming costs to implement a rate change.

6. **Partial exemption applies to sales tax only.** The proposed law would partially exempt sales of disaster preparedness products from the computation of the sales tax, but not the use tax. Therefore, California consumers ordering these items from out-of-state, Internet and mail order retailers, for example, would continue to remain liable for the use tax during the specified period.
7. **The delayed operative date** of January 1, 2008 should allow the Board, retailers, and consumers sufficient time to prepare for and be aware of the sales tax holiday for disaster preparedness products. The sales tax exemption for the qualified products is to occur over a nine-day period beginning at 12:01 a.m. on the first Saturday in October and end at midnight on the second Sunday in October. As currently written, the exemption periods would be October 4 through October 12, 2008, October 3 through October 11, 2009, and October 2 through October 10, 2010.

## COST ESTIMATE

Administrative costs would be incurred in preparing and mailing a special notice to affected retailers, creating and distributing new sales tax charts to affected retailers, and answering potentially numerous inquiries. Because of the potential for a partial tax exemption with varying local tax rates, administrative costs would also be incurred in computer programming, return revision, return analysis, and return processing. A detailed cost estimate is pending.

## REVENUE ESTIMATE

### BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

This bill would partially exempt from the sales and use tax, the gross receipts from the sale of qualified disaster preparedness products sold to a purchaser for a specified period. This bill would specify that this partial exemption does not apply to local sales or transaction and use taxes, unless the governing body of the taxing county, city, or district votes otherwise. The exemption shall apply to sales that occur during the nine-day period beginning at 12:01 a.m. on the first Saturday in October and ending at 12:00 midnight on the second Sunday in October, until January 1, 2010. Qualified disaster preparedness products are defined as follows:

Product	Maximum Value
Batteries	\$40
First aid kits	\$40
Battery-operated emergency beacons	\$50
Gas or diesel fuel containers	\$35
Ground anchor systems	\$60
Coolers	\$40
Portable generators	\$850
Lanterns, flashlights, and candles	\$30
Battery and solar powered radios	\$60
Tarpaulins	\$60
Tie-down kits, including bungee cords and ropes	\$60

This proposed partial exemption is patterned after a 12-day June 2005 Florida sales tax holiday for disaster preparedness products. Floridians saved over \$10 million on disaster preparedness products. At a sales tax rate of 6%, the taxable measure for disaster preparedness products purchased amounted to \$167 million (\$10 million divided by .06). Floridians have suffered through 8 major hurricanes over the past two years, and a number of tropical storms. Governor Bush has recommended to the Florida Legislature an annual sales tax holiday to coincide with Hurricane Preparedness Week each May. Floridians have become accustomed to disaster preparedness;



Governor Bush cited a 2005 survey that reported 70% of residents living within 5-miles of the coast had a disaster preparedness plan. Conversely, a recent poll conducted by the *Insurance Information Network of California and Fireman's Fund Insurance Company*, found that only 22% of Californians consider themselves prepared or very prepared for a disaster, a difference of 48%. This difference reflects a general attitude of Californians lack of motivation to prepare for a potential catastrophic disaster such as an earthquake, because while we experience floods and fires on relatively regular basis, earthquakes are far and few between. Floridians face a potential catastrophic disaster each year during hurricane season. Therefore, while we will use Florida as a basis for this estimate, we must factor in a value for the difference in preparedness attitude. We will also factor in California's population which is 212% of Florida's population. Further, we will factor in California's proposed tax holiday period of nine-days. Using the information above, we estimate the following revenue impact:

Florida taxable sales	\$ 167 million
California population adjustment	212%
Estimated California taxable sales	\$ 354 million
California preparedness factor adjustment (48%)	- \$ 170 million
Adjusted California taxable sales	\$ 184 million
California tax holiday period adjustment (3/12)	- \$ 46 million
Total estimated California taxable sales	\$ 138 million

Estimated State revenue loss (6.25%)	\$ 8,6 million
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#### REVENUE SUMMARY

This bill would result in an annual revenue loss of \$8.6 million.

	Revenue Loss (in thousands)
State (5.00%)	\$ 6.9 million
Fiscal Recovery Fund (.25%)	0.3 million
Local Revenue Fund (.50%)	0.7 million
Public Safety Fund (.50%)	0.7 million
	\$ 8.6million

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